

July 31 , 2000

D.T.E. 00-36

Petition of the Berkshire Gas Company, pursuant to G.L. Chapter 164, § 14, for approval and authorization by the Department of Telecommunications and Energy to issue and sell a promissory note or notes on a negotiated basis in the aggregate principal amount of up to \$5,600,000, to be sold at par, and for such other action or relief as may be deemed necessary or appropriate in connection with the foregoing.

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176 Federal Street

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FOR: THE BERKSHIRE GAS COMPANY

Petitioner

INTRODUCTION

On April 3, 2000, The Berkshire Gas Company ("Berkshire Gas" or the "Company") filed a petition with the Department of Telecommunications and Energy ("Department"), pursuant to the provisions of G.L. c. 164, § 14, for approval and authorization: (1) to

issue and sell a promissory note or notes on a negotiated basis in the aggregate principal amount of up to \$5,600,000 with a maturity of three years; (2) to use the proceeds to repay short-term bank borrowings used as an interim measure to finance the plant; and (3) for such other action or relief as may be deemed necessary or appropriate in connection with the foregoing (Exh. DTE 1-1). The Company's petition was docketed as D.T.E. 00-36.

Pursuant to notice duly issued, a public hearing was conducted on June 30, 2000, at the Department's offices in Boston. The Department did not receive any petitions to intervene in this docket. The Department conducted an evidentiary hearing immediately after the public hearing. The Company presented two witnesses: Michael J. Marrone, Senior Vice President, Treasurer and Chief Financial Officer of the Company; and John J. Puig, Senior Vice President in the Public and Project Finance Group of First Albany Corporation. The evidentiary record consists of 17 exhibits, and responses to two record requests.

As part of the initial filing, the Company also filed a motion to consolidate this proceeding with the Company's petition in docket D.T.E. 00-30 where the Company was seeking the recovery of financing costs associated with its new liquefied natural gas ("LNG") facility through the Company's Local Distribution Adjustment Clause ("LDAC"). On

June 28, 2000, the Company withdrew its request to recover the LNG facility financing costs through the LDAC and its motion for consolidated review.

II. DESCRIPTION OF THE PROPOSED FINANCING

A. Issuance of Notes

The Company proposes to issue and sell to KeyBank National Association ("KeyBank" or the "Bank") a promissory note or notes in the aggregate amount of \$5,600,000, which shall be due in three years and shall bear a variable rate of interest based upon either the London Inter-bank Offered Rate ("LIBOR") rates plus 215 basis points, or the lender's prime rate plus 50 basis points, as elected by the Company from time to time (Exhs. BG-2, Sch. 1; BG-2, at 3; DTE 1-15; Tr. at 31). The notes will be secured by a mortgage on the Company's recently completed LNG storage and vaporization facility in Whately, Massachusetts (Exh. BG-1, Sch. 1).

The Company asserts that the main advantages of the proposed interim financing are that: (1) interim finance costs would be low, resulting in lower short-term interest rates and a limited amortization of principal; (2) lower transaction costs; (3) the right to pre-pay without penalty so that the Company will also be able to enter the long-term debt market at a more appropriate time with a larger, more economical financing; and (4) the proposed financing with KeyBank aids the Company by establishing a new banking relationship for future transactions (Exh. BG-1, at 3; Tr. at 17, 22-24, 35-37).

Use of Proceeds

The proceeds from the issuance and sale of the note or notes would be used as an interim means to finance the Company's recently completed LNG storage and vaporization facility (Exhs. BG-2, at 3; DTE 1-1; DTE 1-2). The plant's construction costs are presently being financed through the Company's current credit facilities which consist of internal sources, short-term borrowings, and reinvestment of dividends (Exh. DTE 1-3, Att. C; Tr. at 32-33). The Company stated that these facilities are also necessary for other general corporate purposes (Tr. at 32-33). The proposed issuance and sale of the note or notes would enable the Company to free-up its credit facilities to finance its ongoing operations (Tr. at 32-33).

The Company stated that it had analyzed various ways to finance its LNG plant (Exhs. BG-1, at 2-3; DTE 1-2). First Albany Corporation ("First Albany"), the Company's financial advisor, assisted in this analysis and later in the solicitation of proposals to finance the plant from banks and other potential lenders (Exhs. BG-1, at 3-4; BG-2, at 2-3; DTE 1-2; Tr. at 12-18). Initially, the Company concluded that an "off-balance sheet" lease financing was the most attractive alternative (Exh. BG-1, at 2-3; Tr. at 14).⁽¹⁾ First Albany then solicited lease financing proposals by contacting eight potential "lessors" (Exhs. BG-2, at 2;

RR-DTE-1; Tr. at 36-39). First Albany asserted that due to the relatively small size of the proposed securities issuance, insurance companies were not considered as attractive as leasing services (Exhs. BG-2, at 4; DTE 1-2; DTE 1-5). Therefore, banks were targeted and a substantial effort was undertaken to establish new banking relationships for the benefit of the Company (Exh. BG-2, at 2-3; Tr. at 15, 29-30). Two banks proposed to finance the plant through such leases, offering generally comparable terms, and Berkshire elected to pursue further negotiations with KeyBank in order to establish a new banking relationship in view of the ongoing mergers in the banking industry (Exh. BG-2, at 2; Tr. at 17-18). Thereafter, however, the Company's accountants determined that the lease structure was not the optimal financing vehicle and the Company engaged in further analysis (Exh. BG-1, at 3).⁽²⁾

The Company determined that an interim financing plan involving a shorter term and variable rate security with unrestricted pre-payment rights was the best financing alternative (Exh. BG-1, at 3; BG-2, at 3; DTE 1-2; DTE 1-5). Further, the Company asserted that such an interim term financing would involve lower interest rates and relatively low transaction costs (Exhs. BG-1, at 3; BG-2, at 3; DTE 1-2; DTE 1-5). The Company also considered that the effects of the pending merger between the Company's parent, Berkshire Energy, and Energy East Corporation was likely to result in lower borrowing costs for Berkshire (Exh. DTE 1-10; Tr. at 16-18). Berkshire stated that it wanted to preserve its flexibility to go to the long-term debt market subsequent to the merger when long-term rates would be expected to be lower.⁽³⁾ Because the notes would not require any "make whole" payment, Berkshire would be able to pre-pay the notes at will and, thus enter the long-term debt market when advantageous (Exh. BG-2, at 3; Tr. at 16-17).

III. CAPITAL STRUCTURE OF THE COMPANY As of December 31, 1999, the Company's total capitalization amounted to \$73,655,000 (Exh. BG-1, Sch. 5). This included \$40,000,000 in long-term debt, \$5,994,000 in common stock, \$20,393,000 in premiums paid on common stock and \$310,000 in preferred stock. (*id.* at Sch. 5). The corresponding capital structure ratios are 45.69 percent equity and 54.31 percent long-term debt (*id.*).

As of December 31, 1999, the Company's utility plant in service was \$112,762,000 with accumulated depreciation of \$35,185,000, resulting in net utility plant of \$77,577,000 (Exh. BG-1, Sch. 4). Total equity and long-term debt was \$66,697,000 (*id.*). Therefore, the excess of utility plant amounted to \$10,880,000 as of December 31, 1999 (\$77,577,000 minus \$66,697,000). The Company indicated that it expected this figure to remain essentially unchanged due to the pro forma adjustments that included the LNG plant addition

(i.e., raising utility plant in service by \$5,530,000 to \$118,292,000) and the issuance and sale of the note or notes (raising total securities and debt by \$5,530,000 to \$72,227,000) (*id.*).

During the hearing, the Company noted that it expected to issue and sell the note or notes in the aggregate principal amount of \$5,600,000 based upon the cost of the LNG plant. The \$70,000 difference from the original projected costs for such plant (approximately \$5.53 million) related primarily to certain issuance, paving and landscaping costs incurred after the winter season (Tr. at. 20).

IV. STANDARD OF REVIEW

In order for the Department to approve the issuance of stocks, bonds, coupon notes, or other types of long-term indebtedness⁽⁴⁾ by an electric or gas company, the Department must determine that the proposed issuance meets two tests. First, the Department must assess that the proposed issuance is reasonably necessary to accomplish some legitimate purpose in meeting a company's service obligations, pursuant to G.L. c. 164, § 14. Fitchburg Gas & Electric Light Company v. Department of Public Utilities, 395 Mass. 836, 842 (1985) ("Fitchburg II") citing Fitchburg Gas & Electric Light Company v. Department of Public Utilities, 394 Mass. 671, 678 (1985) ("Fitchburg I"). Second, the Department must determine whether the Company has met the net plant test.⁽⁵⁾ Colonial Gas Company, D.P.U. 84-96 (1984).

The Court has found that, for the purposes of G.L. c. 164, § 14, "reasonably necessary" means "reasonably necessary for the accomplishment of some purpose having to do with the obligations of the company to the public and its ability to carry out those obligations with the greatest possible efficiency." Fitchburg II at 836, citing Lowell Gas Light Company v. Department of Public Utilities, 319 Mass. 46, 52 (1946). In cases where no issue exists about the reasonableness of management decisions regarding the requested financing, the Department limits its Section 14 review to the facial reasonableness of the purpose to which the proceeds of the proposed issuance will be put. Canal Electric Company, et al., D.P.U. 84-152, at 20 (1984); see, e.g., Colonial Gas Company, D.P.U. 90-50, at 6 (1990).

The Fitchburg I and II and Lowell Gas cases also established that the burden of proving that an issuance is reasonably necessary rests with the company proposing the issuance, and that the Department's authority to review a proposed issuance "is not limited to a 'perfunctory review.'" Fitchburg I at 678; Fitchburg II at 841, citing Lowell Gas at 52. Regarding the net plant test, a company is required to present evidence that its net utility plant (original cost of capitalizable plant, less accumulated depreciation) equals or exceeds its total capitalization (the sum of its long-term debt and its preferred and common stock outstanding) and will continue to do so following the proposed issuance. Colonial Gas Company, D.P.U. 84-96, at 5 (1984). Where issues concerning the prudence of the Company's capital financing have not been raised or adjudicated in a proceeding, the Department's decision in such a case does not represent a determination that any specific project is economically beneficial to a company or to its customers. In such circumstances, the Department's determination in its Order may not in any way be construed as ruling on the appropriate ratemaking treatment to be accorded any costs associated with the proposed financing. See, e.g., Boston Gas Company, D.P.U. 95-66, at 7 (1995).

Pursuant to G.L. c. 164, § 15, an electric or gas company offering long-term bonds or notes in excess of \$1 million in face amount payable at periods of more than five years after the date thereof must invite purchase proposals through newspaper advertisements. The Department may grant an exemption from this advertising requirement if the Department finds that an exemption is in the public interest. G.L. c. 164, § 15. The Department has found it in the public interest to grant an exemption from the advertising requirement where there has been a measure of competition in private placement. See, e.g., Western Massachusetts Electric Company, D.P.U. 88-32, at 5 (1988); Eastern Edison Company, D.P.U. 88-127, at 11-12 (1988); Berkshire Gas Company, D.P.U. 89-12, at 11 (1989). The Department also has found that it is in the public interest to grant a company an exemption from the advertising requirement when a measure of flexibility is necessary in order for a company to enter the bond market in a timely manner. See, e.g., Western

Massachusetts Electric Company, D.P.U. 88-32, at 5 (1988). However, G.L. c. 164, § 15 requires advertising as the general rule; and waiver cannot be automatic but must be justified whenever requested.

Pursuant to G.L. c. 164, § 15A, a company is required to sell long-term bonds, debentures, notes, or other evidence of indebtedness at no less than the par value or face amount unless sale at less than par value is found by the Department to be in the public interest. See, e.g., Boston Edison Company, D.P.U. 91-47, at 13 (1991). The Department has found that it is in the public interest to grant an exemption from the par value requirement where market conditions make it difficult at times for a company to price a particular issue at par value and simultaneously offer an acceptable coupon rate to prospective buyers. Bay State Gas Company, D.P.U. 91-25, at 9 (1991). The Department also has found that it is in the public interest to authorize the issuance of debt securities below par value where this technique offers a company enhanced flexibility in entering the market quickly to take advantage of prevailing interest rates, particularly if this benefits the company's ratepayers in the form of lower interest rates and a lower cost of capital. Id.; see also Boston Gas Company, D.P.U. 92-127, at 8 (1992); Boston Edison Company, D.P.U. 91-47, at 12-13 (1991). If the Department authorizes a company to issue debt securities at less than par value, the Department may establish the method by which the company is required to amortize any discount. (6) G.L. c. 164, § 15A; see, e.g., Boston Gas Company, D.P.U. 92-127, at 8; Boston Edison Company, D.P.U. 91-47, at 15.

V. ANALYSIS AND FINDINGS

Based on the foregoing, the Department finds that the Company's proposed financing consisting of the issuance of note(s) of \$5,600,000 with a term of three years and bearing a variable rate of interest based upon the specified spreads over so-called LIBOR rates or the KeyBank's prime rate, as elected by the Company from time to time, is reasonably necessary to finance the Company's LNG facility, and thus reasonably necessary for some legitimate purpose in meeting the Company's service obligations. The proceeds from the sale of the note or notes will be applied to the refinancing of existing short-term debt used to finance the new LNG facility, plant and equipment and to repay any short-term bank loans incurred from time to time for the temporary financing of such addition or to reimburse the Company's treasury for expenditures for such other purpose as the Department may authorize. As such, the Department finds that the proposed issuance is reasonably necessary to accomplish some legitimate purpose in meeting the Company's service obligations in accordance with G.L.

c. 164, § 14.

After reviewing the record evidence, the Department finds that the Company's proposed issuance of a promissory note(s) meets the net plant test, since the Company's total capital stock and long-term debt will not exceed the Company's net plant after the proposed issuance of the note(s).

Finally, the Department notes that although a public solicitation process is not legally required because the term of the proposed notes is less than the five-year maturity date prescribed under G.L. c. 164, § 15, the Company engaged a financial consultant to develop and assist in the implementation of an appropriate solicitation of interest. Based on the process used by First Albany in the initial solicitation process and the follow-up evaluations, the Department finds that the Company performed due diligence in developing and applying a targeted approach to finance the LNG facility. The Department expects that the Company will continue to pursue a least-cost financing strategy that will secure savings for customers based upon the synergies resulting from the merger.

VI. ORDER

Accordingly, after due notice, hearing and consideration, the Department hereby:

VOTES: That the issuance and sale of promissory note(s) in the aggregate principal

amount of up to \$5,600,000 is reasonably necessary for the purposes for which such issuance has been authorized; and it is

ORDERED: That the Department hereby approves and authorizes the Berkshire Gas Company to issue and sell a promissory note or notes on a negotiated basis in the aggregate principal amount of up to \$5,600,000 for a term of three years, at a variable interest rate based upon either a 215 basis points over so-called LIBOR rates or the Bank's prime rate plus 50 basis points, to be sold at par, and secured by an interest in the Company's LNG plant and to take other action as may be deemed necessary or appropriate in connection with the foregoing; and it is

FURTHER ORDERED: That the proceeds from the issuance and sale of the promissory note or notes in the aggregate principal amount of up to \$5,600,000 at the interest rate described above, shall be used for the purposes described above; and it is

FURTHER ORDERED: That the Secretary of the Department shall within three days of the issuance of this Order cause a certified copy of it to be filed with the Secretary of State of the Commonwealth.

By Order of the Department

James Connelly, Chairman

W. Robert Keating, Commissioner

Paul B. Vasington, Commissioner

Eugene J. Sullivan, Jr., Commissioner

Deirdre K. Manning, Commissioner

Appeal as to matters of law from any final decision, order or ruling of the Commission may be taken to the Supreme Judicial Court by an aggrieved party in interest by the filing of a written petition praying that the Order of the Commission be modified or set aside in whole or in part.

Such petition for appeal shall be filed with the Secretary of the Commission within twenty days after the date of service of the decision, order or ruling of the Commission, or within such further time as the Commission may allow upon request filed prior to the expiration of twenty days after the date of service of said decision, order or ruling. Within ten days after such petition has been filed, the appealing party shall enter the appeal in the Supreme Judicial Court sitting in Suffolk County by filing a copy thereof with the Clerk of said Court. (Sec. 5, Chapter 25, G.L. Ter. Ed., as most recently amended by Chapter 485 of the Acts of 1971).

1. "Off-balance sheet" financing is a type of financing approach that includes lease obligations without corporate guarantees, and thus is not classified as long-term debt on a borrower's balance sheet (Exh. DTE 1-13).

2. Under the "off-balance" financing, the Company would be required to relinquish operating authority of a LNG facility to the lending entity (Exh. BG-1, at 3; Tr. at 13, 26-28). The Company indicated that it was unwilling to transfer control to such lending entity for operating and control reasons (Tr. at 13, 27-28).

3.

3 The Company explained that it determined that long-term rates were relatively high at the time of the analysis in light of Federal Reserve policy (Exh. BG-2, at 3;

Tr. at 15-16).

4. 4 Long-term refers to periods of more than one year after the date of issuance. G.L. c. 164, § 14.

5.

5 The net plant test is derived from G.L. c. 164, § 16.

6. 6 The discount is the difference between the par value of a bond, note, or other debt security and the actual issue price when the actual issue price is less than par value.